

## MACROECONOMICS

### Major assignment

(Total marks...15)

#### Note:

- **Assignment should be in points or in small paragraphs.**
- **Copied assignment from the fellow students will be marked less for both the students.**
- **These topics will also be the part of your final term paper (small general questions)**
- **Last date of submission: 25<sup>th</sup> June 2020 (11:30pm...night)**

**Q1:** Discuss the impact of corona virus on Pakistan's economy.

(You may consider the areas like demand, supply, prices, market, employment, inflation etc)

**Q2:** Explain the functions of Central Bank.

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## **Question No: 1**

**Discuss the impact of corona virus on Pakistan's economy.**

**(You may consider the areas like demand, supply, prices, market, employment, inflation etc)**

### **ANSWER**

#### **Economic impact due to Corona Virus:**

- Fitch Ratings has announced that the economic fallout associated with Covid-19 will challenge Pakistan's ability to narrow the fiscal deficit to 7% in the 2021. Fitch expects a deficit of 9.5% of GDP in 2020 and 8.2% in 2021, pushing the public debt-to-GDP ratio up to 89% of the GDP.
- FDI fell for the 3rd consecutive month in May to \$120 million, from \$133m in April and \$278m in March, mainly due to investors' hesitation for emerging markets in the wake of Covid-19 pandemic. However, the total inflows in the 11 months of current FY still showed an increase of over 90.6 % compared to the last FY. The country received \$2.401 billion during July-May FY20 compared to \$1.260 billion in the same period of last FY.

#### **Trade barriers due to corona virus:**

The government has approved exports of locally manufactured Personal Protective Equipment (PPE).

Import duties have been waived on 16 medical products for 3 months (20/3 to 20/6). Exports of anti-malaria medicines and personal protection equipment are banned; exports of masks (except N95 & PPE) and sanitizers are authorized.

The Ministry of Commerce is considering special tariff measures in the upcoming budget to reduce customs and regulatory duties on more than 1600 raw materials and semi-finished products that are currently subjected to custom duties of more than 5%.

## **Unemployment and Poverty due to Corona Virus:**

The poverty and unemployment estimates by the Pakistan Institute of Development Economics (PIDE) are even direr than those of Pasha and Kardar. In a series of bulletins published on the likely impact of COVID-19, the PIDE presented four possibilities. The worst-case scenario is “high impact,” and entails a 0–1.5 percent GDP growth. PIDE estimates that poverty rate will increase from around 23.4 percent to nearly 59 percent (an additional 75 million people), bringing the total population living below poverty line to 125 million people. However, in light of the looming recession and likely negative GDP growth, this scenario could be a conservative estimate.

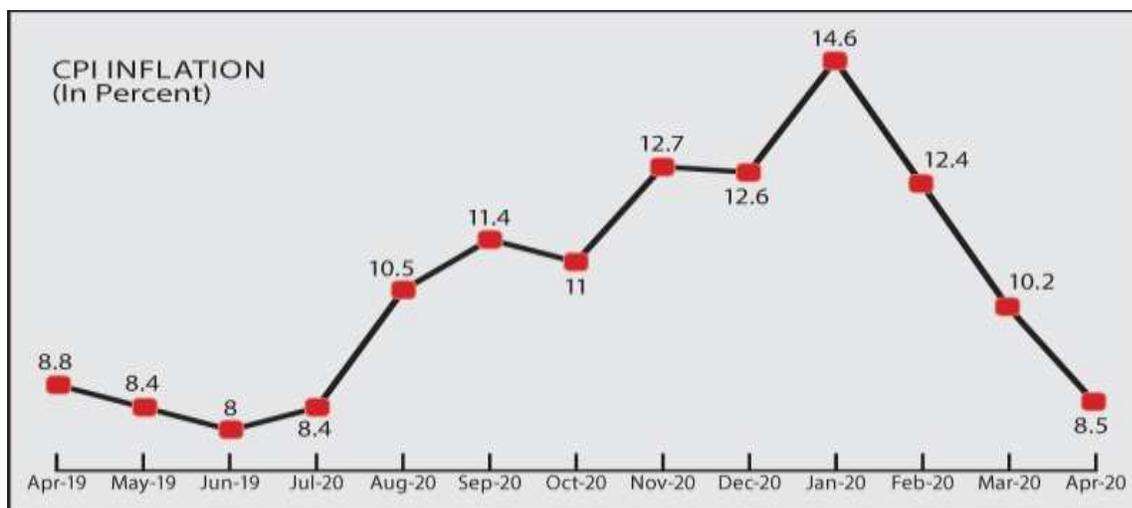
The PIDE has estimated that 56 percent of the workforce falls under “vulnerable employment.” This includes 80 percent of the people employed in agriculture, 75 percent in wholesale and retail trade, 50 percent in hotels and restaurants, 60 percent in real estate and business, and 40 percent in transport and communication sectors. The World Bank expects the brunt of the recession to be borne by the informal sector (which accounts for 72 percent of employment) and daily-wage workers employed in the formal sector (who constitute five percent of the total workforce). According to a PIDE study, in the event of a complete shutdown, around 18.5 million people (30 percent of the employed labor force) who were part of vulnerable employment would be laid off. This scenario is now unlikely, given the relaxation in lockdown. However, even with moderate restrictions, over 12 million people (20 percent of the employed labor force) could lose their jobs. Within the vulnerable employment, the bulk of the layoffs would comprise daily-wage workers and those who work on a piece-rate basis. Formal-sector workers are also at risk. According to one report, one of Pakistan’s largest hotel chains has already laid off 20 percent of its workforce. There is a

growing sense of insecurity about employment in the country. In a survey by IPSOS, 51 percent of the surveyed people (from both urban and rural areas) were concerned about losing their jobs over the next six months. The situation is further exacerbated by the looming prospect of tens of thousands of Pakistanis working in the Middle East, losing their jobs and returning home, which will also impact the remittances that are so critical for Pakistan's balance of payments.

Punjab, the most populous province in Pakistan, will suffer the majority of job losses. PIDE estimates that 10–12 million people in Punjab could get laid off. Compared to other provinces, Sindh has the least number of vulnerably employed, but the estimates are alarming nonetheless, with three to four million people at risk of job loss. For the other two provinces, PIDE data suggests that two million in Khyber Pakhtunkhwa and one million in Balochistan are likely to be rendered unemployed.

According to the calculations of Pasha and Kardar, the unemployment rates by province will be 16 percent for Punjab, 15 percent for Sindh, 14.5 percent for Khyber Pakhtunkhwa, and nine percent for Balochistan.

## INFLATION DUE TO CORONA VIRUS:



“Pakistan witnessed highest inflation not only in comparison with the developed economies but also with emerging economies,” said the Inflation Monitor for April issued by the State Bank of Pakistan (SBP).

The SBP pushed up interest rates to cool down the inflationary pressure during the fiscal year but high rates proved counterproductive as they further increased inflation while the private sector stopped borrowing costly money hampering industrial growth and services.

January witnessed 12-year high inflation at 14.6 per cent. In response to the rising prices, the SBP rose the interest rates to 13.25pc.

However, with the emergence of corona virus, the entire economic scenario was turned upside down as demand contraction lowered inflation forcing the SBP to cut down interest rates to 5.25pc within just three months.

The rate cut announcement came as inflation slowed down, falling to 8.2pc in May, much lower than the SBP projections for the month.

The July-May inflation for the current fiscal year slipped below to the State Bank’s earlier projection of 11pc to 10.94pc. The number is expected to drop further in June.

The government has slashed petroleum prices thrice during the two months, which drastically reduced the cost of production, transportation and finally reduced inflation.

Trade and industrial sectors, while demanding cuts to interest rate, also believe the economy needs additional injection of Rs3-4 trillion for full recovery.

However, with sharp economic slowdown, the revenue collection has also fallen short of target this year making further liquidity injection on such a large scale impossible for the government.

The SBP has provided relief amounting to hundreds of billions in the form of principal payments deferrals, debts rescheduling and lending on easier terms for industrial sector to avoid massive layoffs.

## **Question No: 2**

### **Explain the function of Central Bank.**

#### **ANSWER**

#### **Central Bank:**

One of the most important financial institutions in any modern economy is the central bank. A central bank is an agency of government that has important public policy function such as, monitoring the operations of the financial system and controlling the growth of money supply.

Again, a central bank is an institution charged with the responsibility of regulating the supply, availability, and cost of money in the interests of the general public. To regulate the quantity of money, the central bank is given a special group of powers which other institutions do not possess or which they possess in only a limited degree. These special powers may be allowed to more than one institution, although only one institution is generally known as the central bank.

Today almost all countries have central banks. It is only in the present century that the importance of central banking gained wide recognition. The establishment of the central bank in the modern sense dates back to the nineteenth century to be sure, the state bank of Sweden, the oldest central bank,

dates back to 1668 and the Bank of England, the most celebrated of all central banks was established in 1694.

According to Sayer's "the central bank is an organization of the government that undertakes the major financial operations of the government."

De Kock defined a central bank as, a bank which contributes the open of the monetary and banking structure of the country."

According to the Bank for International settlements, a central bank is defined as "The Bank in any country to which has been constructed the duty of regulating the volume of currency and credit in that country."

According to the Oxford dictionary of economics, "a bank which controls a country's money supply and monetary policy, it acts as a banker of the other banks and a lender of last resort."

From the above discussion, we can say that the bank which controls all economic activities of all financial institution and works as a monetary representative and adviser is called Central Bank. So we can say that the central bank is the guardian of the money market.

## **Functions of Central Bank:**

### **1. Issue of Notes:**

The first and main function of a central bank is the issuing of notes. Since central bank issues notes, it controls the supply of money in the country. When the supply of money increases, then to reduce the supply of money, the central bank collects money by using open market operation rule. As a result, the excess supply of money will decrease from the market. Similarly, if the supply of money is less in the market then govt. will return these (such as a bond). As a result, the supply of money will increase.

## **2. As the Banker to the State:**

The second important function of a central bank is to act as a banker to the government. All the balances of the government of the country are kept with the central bank. On these balances, usually, the central bank pays no interest. On the other hand, the bank performs some services to the government. Generally speaking, it is the fiscal agent of the government and advises the latter in matters relating to currency and exchanges as well as finance. It carries out their exchange, remittance and other bank operations including the management of public debt.

## **3. Banker's Bank:**

Broadly speaking, the central bank acts as a banker's bank in their capacities: 1. As the custodian of the cash reserves of the commercial banks. 2. As the lender of the other bank. 3. As a bank of central clearance, settlement and transfers. For example, if other banks of the country 5% cash reserves of their deposit in the central bank, so, at any time, they can borrow the money as loan from the central bank.

## **4. As the Guardian of the Money Market:**

Central Bank acts as the guardian of the country's money market as the director and controller of the money market. It also controls the money currency, controls credit, stability in money supply and an exchange rate of foreign currency etc. It establishes a country's well organized and develops money market.

## **5. Lender of Last Resort:**

The central bank is the lender of last resort to the commercial banks. When the commercial banks have exhausted their own resources and have failed to supplement their funds from the usual outside resources, the central bank is called upon to function as the lender of last resort.

## **6. Foreign Exchange Control:**

The country's export and import as well as international trade success rate largely depend on the good conduct and control of the foreign exchange. So, foreign exchange system is controlled by the central bank.

## **7. Maintaining Foreign Exchange Reserve:**

High level of crisis and abundance of foreign exchange are harmful to the economy. The central bank maintains sufficient foreign exchange so that there is no problem in case of export and import trade.

## **8. Keeping the Government account:**

Receiving and transferring government fund, the central bank maintains the account of various governments division, ministry and organization i.e. central bank keeps the account of all monetary and economical transactions.

## **9. Revenue Collection:**

As the bank of government central bank helps to collect revenue by collecting different types of tax, duty.

## **10. Maintenance of Information:**

The central bank does the task of collecting and preserving all sorts of information which are much helpful in case of various government planning.

## **11. Co-coordinator:**

The central bank plays the role of co-coordinator by maintaining a relationship with other foreign banks and international economic organization.

## **12. Clearing House:**

The last settlement of the mutual assets and liabilities of other banks are operated by the central bank. So central-bank works as a clearinghouse.

### **13. Act as an Advisor:**

The central bank delivers suggestions or instructions to commercial banks by providing various kinds of financial information. Central bank helps the commercial banks as well.

# **THE END**